

## Kopio: Budget review 2016 - SPRING 2016



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# Economic outlook

Recent news about the global economic outlook has again highlighted cause for concern. Growth prospects in China have deteriorated further, and the Russian economy remains on a downward course. On the other hand, many of Finland's major trade partners have seen healthy economic development. It is predicted that the US economy will reach growth of almost 3 % over the next couple of years, and in the UK economic growth is broadly based. The euro area, too, is back on a track of moderate growth. The monetary policies conducted by central banks remain supportive of growth. Lower energy prices, and oil prices in particular, are good news for the growth prospects of energy-intensive economies such as Finland.

The Finnish economy is in an extremely difficult situation. The economy has declined for the past three years, and will show virtually no growth in 2015. Over the next couple of years, too, economic growth will be slower than in our competitor countries. The annual growth forecast for 2016 is 1.3 % on the back of favourable investment trends.

Employment trends in early 2015 have been weak and the average annual unemployment rate is predicted to come in at 9.6 %. In 2016 it is expected that the numbers employed in the labour market will start to edge up with the slight improvement in the cyclical situation, but the unemployment rate will remain high. Consumer prices will accelerate, but inflation will still remain moderate at around one per cent in 2016.

Development of national economy						
December 2015 forecast						
	2012	2013*	2014*	2015**	2016**	2017**
GDP at market prices (EUR billion)	200	203	205	206	211	216
GDP, change in volume (%)	-1.4	-1.1	-0.4	0.2	1.2	1.2
Unemployment rate (%)	7.7	8.2	8.7	9.4	9.4	9.0
Employment rate (%)	69.0	68.5	68.3	68.1	68.5	68.8
Consumer price index (%)	2.8	1.5	1.0	-0.1	0.9	1.4
Long-term interest rate (10-year bonds) (%)	1.9	1.9	1.4	0.7	1.0	1.5

## Public finances to remain in the red

General government in Finland consists of central government, local government, earnings-related pension funds and other social security funds.

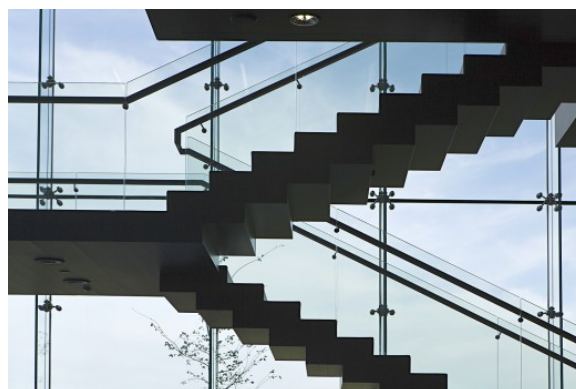
Persistent cyclical weakness coupled with long-term structural problems have driven Finland's general government finances into a permanent state of deficit during the current decade. It is expected that general government will remain in deficit until the end of the decade, although substantial adjustment will help to reduce the amount of deficit.

In recent years the Finnish economy's growth prospects have been adversely affected by ongoing industrial restructuring. Economic growth prospects in the years ahead are furthermore undermined by the declining population of working-age people. The challenge of balancing public finances is further compounded by population ageing, which is driving up pension expenditure as well as health care and long-term care costs.

The growth of age-related expenditure is undermining the budgetary position of general government to such an extent that if tax rates remain unchanged and if the foresee-

able economic development remains within normal range, general government revenue will not suffice to cover general government expenses. Without corrective measures, public debt to GDP is at risk of spiralling out of control. The Ministry of Finance's current estimate is that this so-called sustainability gap is currently around 3.5 % of GDP. This is about one percentage point lower than the spring 2015 estimate, which is mainly explained by the fact that the current estimate takes into account the adjustment measures set out in the Government Programme.

General government finances						
Key figures measured in terms of national accounting in ratio to GDP, percent						
	2012	2013*	2014*	2015**	2016**	2017**
Taxes and social security contributions (% of GDP)	42.7	43.8	43.9	44.6	44.5	44.2
General government expenditure (% of GDP)	56.1	57.6	58.2	59.1	58.7	58.3
Net lending (% of GDP)	-2.1	-2.5	-3.3	-3.3	-2.9	-2.6
— central government	-3.6	-3.6	-3.9	-3.1	-2.9	-2.7
— local government	-1.1	-0.7	-0.8	-0.9	-0.9	-0.8
— earnings-related pension funds	-2.4	1.8	1.7	1.2	1.1	1.1
— other social security funds	0.2	0.0	-0.3	-0.5	-0.2	-0.1
General government debt (% of GDP)	52.9	55.6	59.3	62.8	64.9	66.6
Central government debt (% of GDP)	42.0	44.3	46.4	48.5	49.9	51.3



# Government economic policy line

The objective of Prime Minister Juha Sipilä's Government is to bring the Finnish economy to a path of sustainable growth and increasing employment, and to secure the funding of public services and social security. The Government is committed to a restructuring programme that will promote employment, entrepreneurship and economic growth. Steps will be taken to improve conditions for business and incentives to work, coupled with investments in new opportunities for sustainable growth.

According to the Government Programme efforts to rebalance public finances will begin immediately. The growth of public debt to GDP will be halted by the end of the government term and no further debt will be incurred after 2021. During its term in office the Government is committed to making the savings and restructuring decisions that are necessary to cover the EUR 10 billion sustainability gap. The focus of taxation will be shifted from taxing labour and entrepreneurship towards environmentally and health motivated taxation. The total tax rate will not increase during the parliamentary term.

The Government has agreed on a consolidation programme to strengthen public finances. The measures under this programme cut across all sectors of society and will affect all people. At the same time, reallocations will be made to increase the guarantee pension, to improve child welfare and to strengthen society's internal and external security.

The Government will launch a reform programme to achieve the strategic objectives set for the government term. By the end of

2018, a one-off investment of EUR 1.6 billion will be made to support key government projects and to reduce the repair debt.

The Government was disappointed in its efforts to negotiate an inclusive social contract. Despite the collapse of these negotiations the Government is determined to persist with its efforts to improve Finnish competitiveness, and on 8 September 2015 announced a series of exceptional measures to be put in place to reduce unit labour costs by 5 % and to strengthen employees' redundancy security. Prime Minister Sipilä will submit to Parliament a government statement on the proposed plans for increasing competitiveness by the end of September 2015.

## Fiscal policy rules

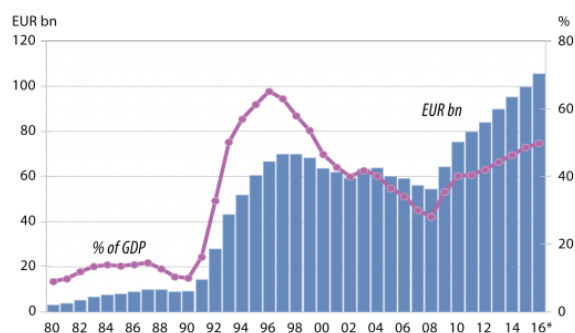
General government fiscal targets are governed by national and EU regulations, particularly the Growth and Stability Pact, which requires that Member States maintain structural balance in general government and avoid excessive deficits and government debt.

In 2014 the national accounts deficit in general government exceeded the 3 % threshold set out in the Treaty on the Functioning of the European Union. The threshold will be exceeded in 2015 as well. According to the Ministry of Finance's September forecast the adjustment measures for 2016 decided by the Government, when implemented in full, will be enough to bring the general government deficit below the 3 % threshold in 2016. In other words Finland will be in compliance with the deficit criterion, as antici-

pated by the European Commission in June 2015. Finland's public debt will exceed the 60 % limit in 2015 and the debt criterion will be breached from 2016 onwards. However this does not in itself trigger an excessive deficit procedure.

Government policy is also informed by the medium-term objective (MTO) set for the structural balance of public finances, which is a deficit to GDP ratio of no more than 0.5 per cent. The Government has agreed on binding budgetary balance targets for individual general government sectors in order to ensure that the MTO is met.

Central Government Debt



# Key projects



The Government Programme identifies five key strategic objectives. These are to strengthen employment and competitiveness; to develop knowledge and education; to promote health and well-being; to advance the bioeconomy and clean solutions; and to develop best practice solutions through digitalisation, experimentation and deregulation. These strategic objectives are furthered through key projects outlined in the Government Programme as well as through reforms to restructure the social and health care system, to reduce the tasks and obligations of municipalities, and to streamline regional administration.

In 2016–2018 the sum of EUR 1.0 billion will be invested in key government projects and EUR 0.6 billion in reducing the transport infrastructure repair debt.

## Financing for key projects:

- employment and competitiveness: EUR 170 million
- knowledge and education: EUR 300 million
- health and well-being: EUR 130 million
- bioeconomy and clean solutions: EUR 300 million
- digitisation, experimentation and deregulation: EUR 100 million

These key projects will be primarily financed out of revenue from dividends and sales of central government shareholdings. EUR 330 million of the required funding will be covered by reallocating funds that had been earmarked for the now postponed City Rail Loop project.

In 2016 investment in key government projects will amount to EUR 223 million, and EUR 100 million is earmarked for reducing the transport infrastructure repair debt.

*EUR 223 million in key government projects and EUR 100 million in reducing the repair debt in 2016.*

The pictures below provide some examples of investment in key government projects in 2016.



## EMPLOYMENT AND COMPETITIVENESS

- The Team Finland network will be strengthened by recruiting commercial and financial experts to work at selected diplomatic missions abroad, which will incur an additional cost of EUR 1.8 million in 2016.
- EUR 10 million will be spent on the capitalisation of Tekes Venture Capital, bringing total government investment to EUR 30 million. The aim is to promote the commercial application of research results.
- EUR 8.5 million is allocated in discretionary government transfers to support business internationalisation and to promote entrepreneurship.
- Additional funding of EUR 10 million is allocated to step up the digitisation of TE Office services, and EUR 5 million is made available to increase private employment services.
- EUR 9 million is allocated for the start-up of regional innovations and experiments.



## KNOWLEDGE AND EDUCATION

- EUR 6 million will be made available in 2016 to accelerate the adoption of digital materials and to support digital learning experiments and development, plus EUR 8.5 million to support education and further training aimed at improving teachers' digital skills.
- The Academy of Finland's budget authority will be increased by EUR 30 million and Tekes funding by EUR 14 million in order to support projects aimed at strengthening business-academia cooperation and at facilitating the commercialisation of innovations.
- The Schools on the Move project will be rolled out across the country in order to encourage a minimum of one hour of physical exercise a day. Funding will be increased by EUR 7 million.
- The sum of EUR 1.5 million is allocated to developing and reforming processes and procedures in young people's services in social and health care in accordance with the youth guarantee scheme.



## HEALTH AND WELL-BEING

- A total of 23.5 million will be invested in key health and well-being projects in 2016. These include service voucher and basic income experiments as well as an assessment of the effectiveness of housing-based social security.



## BIOECONOMY AND CLEAN SOLUTIONS

- EUR 30 million is earmarked for cleantech and bioeconomy solutions and for supporting the commercialisation of new innovations.
- EUR 20 million will be made available in investment aid for renewable energy and new energy technology projects.
- The budget for 2016 includes an allocation of EUR 14 million to the Fund for Agricultural Development (MAKERA), mainly earmarked for key projects aimed at the developing the bioeconomy and promoting the structural development of agriculture and increasing its competitiveness.
- Additional funding of EUR 11.4 million is allocated to key projects in natural resources economy in 2016. The purpose is to support the development of more diversified uses of wood, strengthen Finnish food production, accelerate the transition towards a circular economy, and promote the regeneration of fish stocks.
- A special grant for the VTT Technical Research Centre research infrastructure includes an additional authority of EUR 5 million for the development of high-quality research and pilot infrastructures in the bioeconomy field.
- Additional funding is made available to increase the recycling of nutrients, to develop the associated regulatory mechanisms and to protect the Baltic Sea and waterways. Furthermore, a new national park will be established to commemorate the centenary of Finnish independence in 2017. A national programme for the rehabilitation of contaminated land areas will also be launched as a key government project.



## DIGITISATION, EXPERIMENTATION AND DEREGULATION

- EUR 24,7 million is allocated to support the digitisation of public administration in 2016.
- EUR 5.9 million is earmarked for the creation of a national income register in 2016.





# Budget figures for 2016

## Budget appropriations and deficit

Proposed appropriations for the 2016 budget amount to EUR 54.1 billion, which is EUR 0.2 billion more than the figure in the ordinary budget for 2015. Given the increase in price levels and the structural changes in the budget, appropriations for the different branches of government will increase in real terms by around 0.4 % from the ordinary budget for 2015.

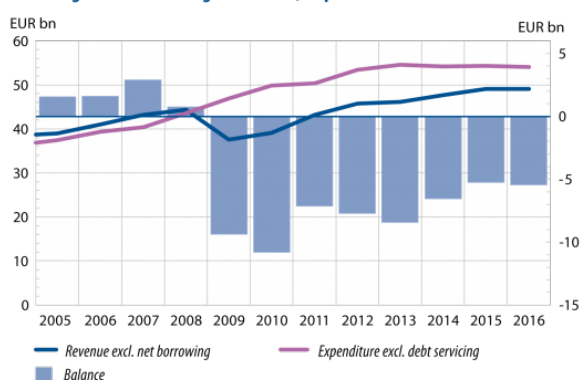
Among the factors contributing to increase the level of appropriations are the revision of the distribution of costs between central and local government, the increased costs from unemployment and immigration, changes to the timing of Defence Forces materiel acquisitions, and investments in key projects. The figure for appropriations take into account the adjustment measures announced in the Government Programme, which will reduce central government expenditure by a net total of over EUR 0.7 billion in 2016.

On-budget revenue for 2016, excluding net borrowing, is estimated to come in at around EUR 49.1 billion. The budget proposal for 2016 shows a deficit of EUR 5.0 billion, which will be covered by increased borrowing. The deficit will decrease by over EUR 200 million compared with the budgeted figure for 2015 (including supplementary budget proposals).

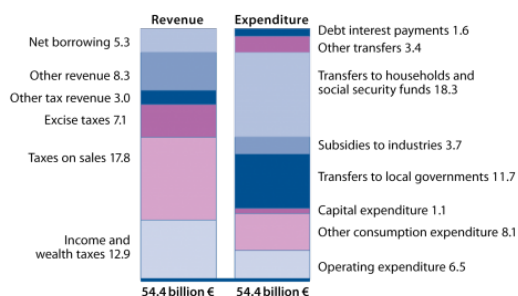
At year-end 2016 it is estimated that central government debt (including the debt of off-budget entities) will be around EUR 106 billion, or approx. 50 % of GDP.

*will reach EUR 106 billion. Appropriations are EUR 54.1 billion, and revenue EUR 49.1 billion.*

Central government budget revenue, expenditure and balance



Central government budget revenue and expenditure in 2016, EUR billion



## Central government debt

## Adjustment measures to curb borrowing



The Government Programme outlines a series of measures to reduce public expenditure and to increase revenue. These measures are foreseen to have a net consolidation effect of EUR 4 billion on public finances at an annual level in 2019. The effects of taxation changes are not included in this assessment. A more accurate picture has been gained of the effects of the proposed measures during the preparation of the budget proposal. In addition, further savings decisions have been taken to help achieve the Government Programme's adjustment targets. The single most significant decision was to freeze the indexation of benefits paid out by The Social Insurance Institution of Finland<sup>1</sup>, Kela as well as benefits tied to the cost of living index (excluding social assistance) in 2017–2019.

The 2016 budget proposal incorporates the savings, increases in fees and charges and some of the expenditure increases set out in the Government Programme, which will improve the balance of central government on-budget finances by a net total of over EUR 0.8 billion. The biggest expenditure savings at an annual level in 2016 include those coming from

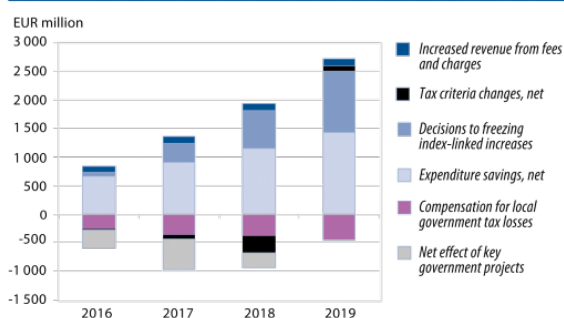
- indexations (– EUR 70 million),
- development cooperation (– EUR 200 million)
- health insurance reimbursements (– EUR 70 million),
- education, including early education and basic, upper secondary and higher education (– EUR 150 million),
- business and industry aid (– EUR 80 million),
- administration and ICT expenses (– EUR 50 million).

Selected expenditure savings in different administrative branches are described in a separate section below ('Excerpts from the budget proposal').

The budget proposal includes the following expenditure increases in line with the Government Programme

- internal security (+ EUR 50 million),
- Defence Forces' materiel procurements (+ EUR 50 million).

**Impact of adjustment measures during 2016-2019 parliamentary term on central government finances, EUR million**



At the start of the parliamentary term, the Government sets the overall spending limits, or a ceiling for budget expenditure during that term. The Government's first spending limits decision, the framework for the 2016–

<sup>1</sup><http://www.kela.fi/web/en/terms-of-use>

2019 term, is part of the 2016–2019 General Government Fiscal Plan, which will be submitted to Parliament in connection with the 2016 budget proposal. Expenditure under the central government spending limits, at an annual level in 2019, will be EUR 1.3 billion lower than under the spending limits adopted on 2 April 2015. Appropriations in the 2016 State Budget foresee a reduced expenditure level in accordance with the spending limits decision.

## **Tax revenue**

On-budget revenue for 2016 (excluding net borrowing) is estimated at around EUR 49.1 billion, with tax receipts accounting for around 83 % or EUR 40.8 billion. Compared with the ordinary budget, it is estimated that on-budget revenue will decrease by some EUR 0.1 billion. This fall is explained by exceptional items included in the 2015 revenue forecasts, most notably one-off

revenue from sales of shareholdings.

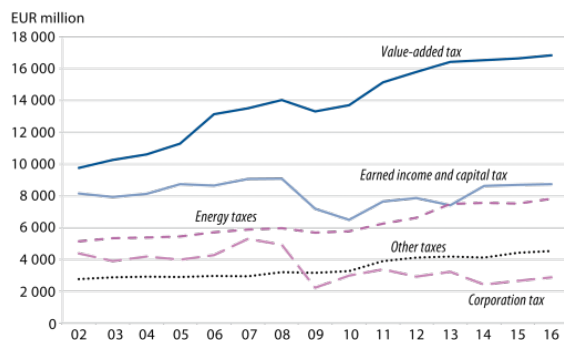
It is projected that tax revenue in 2016 will increase by 2 % or some EUR 0.9 billion compared with the 2015 budget. The development of tax revenue depends upon the development of tax bases and changes made to tax criteria.

The Finnish economy has seen no growth in three years. The Ministry of Finance's outlook expects the economy to move to slow growth in 2016. However, the sluggishness of the economy will continue to hamper tax base growth in 2016. Together with decisions already taken earlier, the proposed changes to tax criteria will increase central government tax revenue in 2016 by around EUR 0.4 billion at an annual level. In 2016 the tax increases announced in Prime Minister Sipilä's Government Programme will focus mainly on indirect taxes, at the same time as taxes on labour are reduced. Specific tax criteria changes are detailed below under the heading 'Excerpts from the budget proposal'.

Statens inkomstskatteskala 2016		
Beskattningsbar förvärvsinkomst euro	Skatt vid nedre gränsen, euro	Skatt på andelen som överskrider nedre gränsen, %
16 700 - 25 000	8	6,5
25 000 - 40 800	547,5	17,5
40 800 - 72 300	3 312,5	21,5
72 300 -	10 085	31,75

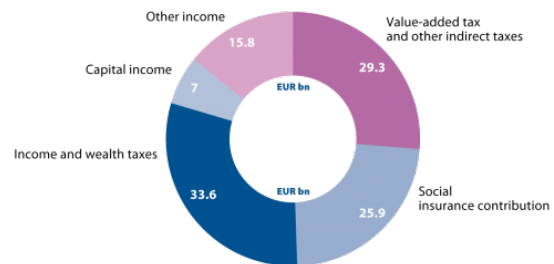
Value-added tax rates in 2016	
General tax rate	24 %
Reduced tax rate ► foodstuffs, animal feed and restaurants' food services	14 %
Reduced tax rate ► e.g. medicine, passenger transport, accommodation services, sports and recreation services, cultural services, books, newspaper and magazine subscriptions	10 %

#### State tax revenue by tax type, years 2002-2016



#### Where do tax euros derive from?

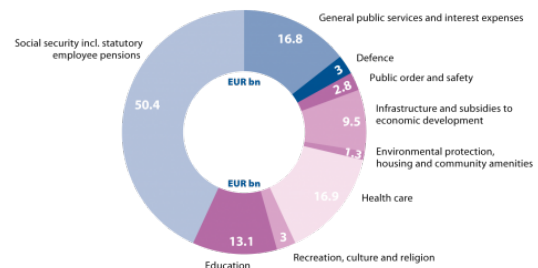
General government revenue in 2013: EUR 111.6 bn / 55.0 % of GDP (2012: 107.9 md. euro / 54.0 %)



SOURCE: Statistics Finland, National Accounts

#### What are tax euros spent on?

General government expenditure in 2013: EUR 116.7 bn / 57.6 % of GDP (2012: EUR 112.2 bn / 56.1 %)



SOURCE: Statistics Finland, National Accounts

## **Social benefits and cost of public services**

Selected monthly <sup>1</sup> benefits in 2016, part 1		
	EUR/ month 2016	EUR/ month 2015
<b>Full national pension</b>		
<i>From 1 Jan. 2016</i>		
- living alone	634.30	636.63
- married	562.62	564.69
<b>Guaranteed pension</b>	766.85	746.57
<b>Child benefits</b>		
- 1 <sup>st</sup> child	95.75	95.75
- 2 <sup>nd</sup> child	105.80	105.80
- 3 <sup>rd</sup> child	135.01	135.01
- 4 <sup>th</sup> child	154.64	154.64
- 5 <sup>th</sup> child and each child thereafter	174.27	174.27
- single parent supplement per child	48.55	48.55
<b>Sickness insurance daily allowances</b>		
- minimum level for sickness, maternity, paternity and parental allowances	598.25	600.50

<sup>1</sup> Benefits granted on a daily basis are estimated on a monthly level.

Average expenses of selected public services in 2013		
EDUCATION AND CULTURE	EUR	
basic education	8 780	/pupil
upper secondary education	7 585	/student
initial vocational education	11 845	/student
polytechnic education	8 005	/student
university education	9 900	/student
public libraries	3	/loan
SOCIAL SERVICES	EUR	
children's day care <sup>1</sup>	60	/day
old people's homes <sup>2</sup>	138	/day
HEALTH CARE SERVICES	EUR	
Basic health care		
- visit to health centre	89	/visit
- ward treatment	215	/day
- dental care	79	/visit
Special medical treatment		
- somatic special medical treatment <sup>3</sup>	1 151	/day

<sup>1</sup> Includes both day care centre and family day care costs and care days. Part-time and full-time day care costs have not been commensurated.

<sup>2</sup> Figure for 2013 is not fully comparable with earlier years because of the discontinuation of the Kainuu regional experiment. Figures for the municipalities in Kainuu are not included prior to 2013.

<sup>3</sup> Includes inpatient care and day surgery.

Sources: National Board of Education, Ministry of Education and Culture, National Institute for Health and Welfare and Statistics Finland.

Number of library loans: Suomen yleisten kirjastojen tilastot <http://tilastot.kirjastot.fi/>.

Selected monthly <sup>1</sup> benefits in 2016, part 2		
	EUR/ month 2016	EUR/ month 2015
<b>Child home care allowance</b>		
- allowance for one child under three years of age	341.27	342.53 <sup>2</sup>
<b>Private childcare allowance</b>		
- allowance per child	173.74	174.64
<b>Partial child care allowance/parent</b>	97.73	98.09
<b>Basic unemployment security</b>		
- basic unemployment allowance	702.62	705.20
- labour market subsidy	702.62	705.20
<b>Student financial aid, maximum amounts<sup>2</sup></b>		
<i>Student grant</i>		
Higher education students		
- not living at home, 17 year olds	147.52	147.52
- not living at home, 18 + years	303.19	303.19
University students enrolling for the first time after 1 Aug 2014		
- not living at home, 17 year olds	163.80	163.80
- not living at home, 18 + years	336.76	336.76
Other students		
- not living at home, 17 year olds	101.74	101.74
- not living at home, 18 + years	250.28	250.28
<i>Student housing supplement</i>		
- 80% of established housing costs <sup>3</sup>	201.60	201.60
<i>State guarantee for study loans</i>		
- Higher education students	400.00	400.00

<sup>1</sup> Benefits granted on a daily basis are estimated on a monthly level.

<sup>2</sup> As of 1.8.2015 the grant is divided in half between parents.

<sup>3</sup> The allowance is not granted for the part of the monthly housing cost that exceeds EUR 252.

# Local government finances

## **Central government transfers to local governments set to increase in 2016**

Municipalities are responsible for the provision of a range of basic public services, such as education and social and health care. Funding for these services comes mainly out of local government tax revenue, which consists of municipal taxes (86 %), property taxes (8 %) and a share of corporate income tax revenue (6 %). Central government contributes to financing basic public services through a system of central government transfers to local governments. These transfers are determined by imputation and are universal, which means that local authorities can allocate the funds at their discretion. Furthermore, central government provides grants to municipalities for the performance of specific tasks and functions.

The central government transfer percentage illustrates the division of costs between central and local government. In 2016 the central government transfer percentage for basic public services in local government is 25.52. This means that local government accounts for 74.48 per cent of the funding needed for basic service provision. The central government transfer percentage for post-primary education financed by the Ministry of Education and Culture is 41.89.

In 2016 central government will be paying out a total of EUR 11 billion in transfers to local governments. This represents an increase of around EUR 0.5 billion on the figure for 2015.

In 2016 the level of central government trans-

fers to local governments will increase by EUR 300 million as a result of a revised division of costs between central and local government. The compensation of municipalities' tax losses will also increase the amount of central government transfers. Transfers to finance home help for families with children and child welfare will be increased by a total of EUR 10 million: this is intended to support implementation of the Social Welfare Act that took effect from the beginning of 2015. Central government transfers will be reduced by Government Programme measures designed to ease the cost burden of local governments. The subjective right to day care will be limited, staffing levels in early childhood education revised and steps taken to find efficiencies in regional specialised health care. No index-linked increases will be made to central government transfers. Government transfers granted for purposes of reducing group sizes in basic education will be discontinued. In addition, some of the other transfers granted for the improvement of the quality of general education will be discontinued.

Local government tax revenue in 2016 is estimated to come in at around EUR 21.7 billion, about 0.5 % less than one year earlier. It is estimated that overall, cuts and increases to taxes on earned income will reduce local government tax revenue by a total of EUR 262 million. The central government transfer to support public service provision will be increased accordingly. The lower and upper tax limits of real estate tax rates will be raised, which is expected to increase local government tax revenue by EUR 25 million. The temporary increase in the share of corporate



income tax revenue paid to local governments will be discontinued, which in annual terms will reduce local government tax revenue by EUR 258 million. More detailed information on the 2016 tax criteria changes is provided under the section 'Excerpts from the budget proposal'.

Local government finances will also be bolstered by the proposed changes to service charges. Day care charges and fees for children's before and after school activities will be increased as of 1 August 2016, and charges for social and health care services will be increased from the beginning of the year.

It is estimated that the central government measures included in the budget proposal will contribute to strengthen the financial position of municipalities by almost EUR 290 million compared with 2015.

The balance in financing local government tasks and obligations is examined in more detail in the local government finance programme, which is compiled in connection with the general government fiscal plan.

### **Local government loan portfolio still increasing**

An imbalance has arisen between local government revenue and expenditure. Results for fiscal year 2014 were bolstered by incorporations of municipally owned enterprises, but in 2015 balance sheets will again show a deficit.

The estimate for local government finances in 2016 is a pressure projection that does not take into account municipalities' own adjustment efforts. The municipal tax rates have been held constant at 2015 level. The structural adjustment measures outlined in the

Government Programme will strengthen local government finances by almost EUR 300 million in 2016. At the same time, however, local government finances will be adversely affected by increasing service needs resulting from population ageing. Fiscal year 2016 will therefore remain in deficit.

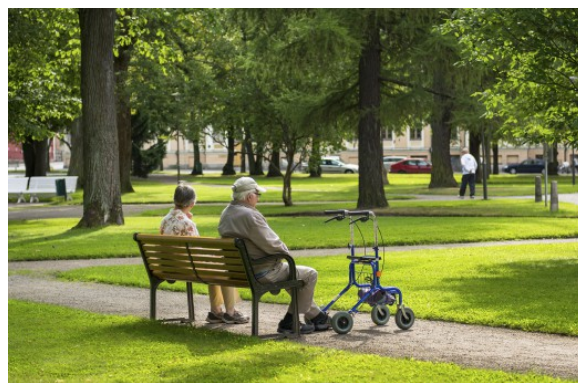
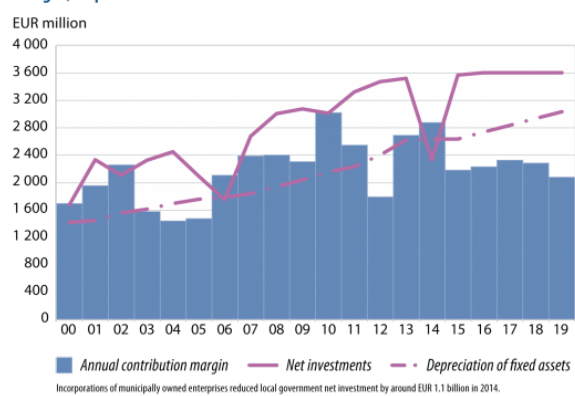
Local government investment has increased sharply in recent years, and based on projected investment needs there is no significant change in sight in the immediate future. In 2016 the total loan portfolio held by the local government sector will increase to almost EUR 20 billion.

In national accounts terms the local government deficit was 0.8 % of GDP in 2014, and it is forecast to remain unchanged at this level over the next few years ahead.

### **Governance of local government finances strengthened**

The governance of public finances has been strengthened from the beginning of 2015. In its first general government fiscal plan in September 2015, the Government of Prime Minister Sipilä set the budgetary objectives for general government and its subsectors, including local government. In 2019 the local government deficit must not exceed 0.5 % of GDP. At the same time, the Government announced the measures it intended to put in place to achieve those objectives. The Government also specified a ceiling for local government expenditure to limit the pressures from central government measures on local government operating expenditure.

# Municipalities' and joint municipal authorities' annual contribution margin, depreciation & net investments



# Central government EU revenue and expenditure in 2014–2016



The European Commission presented the 2016 draft EU budget on 27 May 2015. The sum total of commitments to programmes within the multiannual financial framework is EUR 153 billion, while actual payments represent EUR 143.2 billion. The EU budget amounts to roughly 1 % of total EU GDP.

The EU budget is intended to boost innovation and growth, to create new jobs, to promote convergence among Member States and among regions, to support migration policy and to further strengthen the role of the EU as a global player. The budget proposal also includes contributions to the European Fund for Strategic Investment (EFSI), which is central to the Investment Plan for Europe. Furthermore, the aim is to address payment needs; to make progress towards a new En-

ergy Union; to implement a forward-looking climate change policy; and to show administrative restraint.

Discussions in the EU Council resulted in budget payment cuts of some EUR 1.4 billion from the Commission's proposal. In September 2015 the budget will be presented to Parliament, and the final approval of the 2016 budget will be in November-December 2015.

The EU budget is financed in full from the community's so-called own resources. Own resources consist of traditional own resources (duties and levies on sugar production, approx. 13 %) and other own resources (pension contributions, interests, fines, surplus from previous year, approx. 1 %), payment of which to the EU comes without separate decisions by Member States, and the value added tax resource (approx. 13 %) and the gross national income resource (approx. 13 %), which come through the Member States' budgets.

Parliament and Council decisions concerning EU annual expenditure and revenue must fall within the seven-year financial framework.

The Finnish State Budget has been drafted on the assumption that the changes concerning own resources during the financial framework 2014–2020 shall take effect retroactively during 2016. This will bring an exceptional increase to Finland's annual membership contribution for 2016.

At central government level, Finland is expected to contribute an estimated EUR 2,176

million to the EU budget and the European Development Fund in 2016. Finland's contributions will be EUR 196 million higher than budgeted for 2015. Finland's share of the UK's EUR 5.3 billion budgetary rebate in 2016 is EUR 137 million.

Finland is expected to receive around EUR

1,164 million from the EU budget, which is EUR 126 million less than the projected figure for 2015. Rural development support is expected to decrease significantly toward normal levels. The exceptionally high levels of support in 2015 are explained by the timing of payments following the start of a new EU programming period.

Flow of payments between Finland and the EU 2014–2016 (EUR million)			
CENTRAL GOVERNMENT EXPENDITURE	Final accounts 2014	Budget 2015	Budget 2016
<b>On-budget finances</b>			
VAT payment	284	274	280
GNI payment	1 562	1 396	1 542
Finland's share of the UK budgetary rebate	137	135	129
<i>EU PAYMENTS TOTAL</i>	<i>1 983</i>	<i>1 805</i>	<i>1 951</i>
European Development Fund	48	25	45
<b>TOTAL</b>	<b>2 031</b>	<b>1 830</b>	<b>1 996</b>
CENTRAL GOVERNMENT REVENUE	Final accounts 2014	Budget 2015	Budget 2016
<b>On-budget finances</b>			
Agricultural support	520	515	600
Rural development support	72	556	325
Subsidies from the structural funds and cohesion funds	216	114	120
Custom duties and other levies	42	46	34
Other revenue	31	40	69
<b>Off-budget finances</b>			
Intervention Fund of Agriculture	0	3	1
Fund for Agricultural Development	24	16	15
<b>TOTAL</b>	<b>905</b>	<b>1 290</b>	<b>1 164</b>
Customs duties, agricultural payments and sugar payments collected on behalf of EU	127	184	138

# Excerpts from the budget proposal

## Taxation



### Taxes on earned income and capital income

- In accordance with the Government Programme, taxation on labour will be eased, particularly for low and middle incomes, by increasing the earned income tax credit by EUR 450 million in 2016.
- In earned income taxation, an adjustment corresponding to the change in the Index of Wage and Salary Earnings will be made at all income levels.
- The deductibility of mortgage interest expenditure will be further restricted, such that 55 % of mortgage interest expenditure is tax deductible in 2016.
- A capital loss will be made tax deductible from all capital income, whereas according to current legislation it is tax deductible only from capital gains.
- The validity of the Act on Withhold-

ing Tax for Taxation of Foreign Wage Earners with Special Expertise (so-called Key Individuals Act) will be extended.

- For a fixed period, provisions relating to active repentance will be introduced in taxation. Natural persons or estates will avoid criminal penalties relating to tax fraud if during 2016 they, on their own initiative, declare income or assets previously undeclared in taxation.
- Donations between EUR 850 and EUR 500,000 from private individuals to higher education institutions will be made deductible.
- The higher tax rate for capital income will be raised from 33 % to 34 %.
- As a result of the freezing of the so-called YLE-index, the Finnish Broadcasting Company (YLE) tax will be adjusted accordingly, such that the smallest amount of the tax to be paid is increased from EUR 51 to EUR 70. The lowest income limit at which the tax is levied will rise from around EUR 7,500 to around EUR 10,300 per year.
- The limit of the highest income bracket in the progressive income tax scale, the so-called solidarity tax will be lowered from EUR 90,000 to EUR 72,300 for 2016 and 2017.

### Corporate income tax

- The expiry at year-end 2015 of the temporary increase in the share of corporate income tax revenue paid to lo-

cal governments, and the transfer of parishes' share of corporate income tax revenue to central government from the beginning of 2016, will increase central government's share of this revenue.

## Other taxes

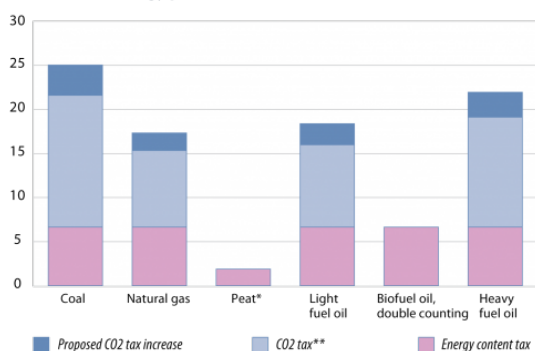
### Excise duties

- The tobacco tax will be increased. As a result of the proposed tax increase it is estimated that revenue from the tobacco tax will increase by EUR 68 million a year.
- Taxes on heating, power plant and machinery fuels will be increased. It is estimated that this will increase central government tax revenue by a net annual total of EUR 75 million.

Excise duty amounts in 2015 and 2016, government's proposal			
	2015	2016 proposal	Tax changes %
	euros		
Average priced cigarettes (20)	3.70	4.15	12.2
Average priced rolling tobacco (30g pouch)	3.46	3.88	12.1
Light fuel oil, sulphur-free (100 litres)	18.74	21.40	14.2
Waste delivered to landfill (tonnes)	55.00	70.00	27.3
Base tax component of vehicle tax for average emissions car, 175 CO <sub>2</sub> g/km (€)*	170	231	35.9
	per cent		
New average emissions car, 124 CO <sub>2</sub> g/km (% of price)	20.8	20.1	-3.4
New low emissions car, 95 CO <sub>2</sub> g/km (% of price)	15.7	14.4	-8.3

\* Previous government's decision

Tax levels for energy products in 2016, €/MWh



\* Peat is not taxed according to energy content or CO<sub>2</sub> emissions as other energy products, but is subject to energy tax.

\*\* CO<sub>2</sub> tax is halved for CHP production.

- As set out in the Government Programme, the car tax will be lowered during the parliamentary term by some EUR 200 million in total. The cuts will be phased in during 2016–2019 in order to avoid sudden changes in consumer behaviour, market distortions, sudden drops in inventory values, and unfair effects to consumers that might follow from a major one-off tax change.
- It is proposed that the annual vehicle tax be raised so as to increase annual central government revenue by EUR 100 million.
- The waste tax will be increased.
- The current estimate is that the unemployment insurance contribution will be increased by one percentage point. This increase will be divided equally between employers and employees.



## Appropriations



## Administration

Both the Government of Prime Minister Juha Sipilä and previous governments have announced operating expenditure cuts across all administrative branches. In 2016 these savings cuts amount to over EUR 300 million.

A unit charged with improving legislative impact assessment will be created under the Prime Minister's Office, with a proposed allocation of EUR 0.25 million.

## Development cooperation

Appropriations for international development cooperation come to EUR 0.7 billion. This is estimated to represent 0.35 % of GNI in 2016. An appropriation of EUR 498 million is proposed for the Ministry for Foreign Affairs' development cooperation item, and EUR 140

million is earmarked for financial investments in development cooperation.

## Public order and security

Appropriations for public order and security will be increased by EUR 50 million as outlined in the Government Programme. Additional funds will be allocated, among others, to courts of law, the Criminal Sanctions Agency, the Police of Finland, the Finnish Border Guard, and Customs.

Support services for victims of crime shall be made available in compliance with the requirements of the EU Victim's Directive together with social and health care administration and non-governmental service providers.

Court fees will be raised and their scope of application extended as outlined in the Government Programme. The changes will be made in such a way that they do not undermine the legal rights of low income earners.

An appropriation of EUR 718 million is allocated to police operating expenditure, slightly less than the figure in the 2015 budget (EUR 734 million). The Finnish Security Intelligence Service will be transferred from the National Police Board to the Ministry of the Interior from the beginning of 2016.

## Immigration

EUR 158 million, EUR 97 million more than in the ordinary budget for 2015, will be allocated to immigration administration, the reception of refugees and asylum seekers and re-entry orientation for returning migrants.

The increasing number of asylum seekers is having a significant impact on immigration administration. In 2011–2014 the number of

asylum seekers was steady at around 3,000–3,700 a year. The numbers started rising in late 2014 and have grown very rapidly during the summer and autumn of 2015. It is difficult to predict how the number of asylum seekers will develop. The appropriations included in the budget are based on an estimate of 15,000 asylum seekers. The number of quota refugees is unchanged at 750–1,050.

Proposed integration policy appropriations amount to EUR 144 million, which is EUR 47 million more than in the 2015 ordinary budget. This increase is explained by the increasing number of people eligible to claim allowances and the increased refugee quota in 2014 and 2015.

## National defence and crisis management

An appropriation of EUR 1.9 billion is proposed for Defence Force operating expenditure, slightly more than in 2015. A total of EUR 594 million is proposed for defence materiel acquisitions, EUR 177 million more than in the ordinary budget for 2015. This increase is mainly attributable to the deferral of payments for earlier acquisitions and the Government's commitment to step up investment in defence materiel by EUR 50 million in 2016. Furthermore, the budget proposal includes an authorisation of EUR 314 million for purposes of improving the country's military defence capability.

Appropriations allocated for military crisis management take into account Finland's leading role in the UNIFIL operation in Lebanon: this role continues until 31 May 2016.

## International organisations

The budget proposal recommends that authorisation be granted for initial subscription to the capital stock of the Asian Infrastructure Investment Bank (AIIB) at a total cost of USD 62 million in 2016–2020, and for payments on subscriptions to callable capital of USD 248.3 million based on AIIB membership.

## Early childhood education and general education



Changes will be made to the subjective right to day care as of 1 August 2016. The changes mean that every child will be entitled to receive 20 weekly hours of early childhood education until they reach pre-school age. Children will have the right to full day early childhood education if this is necessary on grounds of their parent's or other guardian's studies, paid employment, self-employment, or entrepreneurship. It is estimated that these

changes will reduce local government annual expenditure by EUR 62 million. Central government transfers for the provision of basic public services will be reduced accordingly by EUR 15.9 million.

Furthermore, the ratio of trained staff to children aged 3 or over will be revised from 1:7 to 1:8 as of 1 August 2016. This will gradually reduce local government expenditure from 2016 onwards. Annual local government expenditure is expected to decrease by around EUR 67 million. The corresponding reduction in central government transfers is approx. EUR 17 million.

An early education development programme will be launched to improve the pedagogical quality of early education and to increase training for kindergarten teachers on a temporary basis. An appropriation of EUR 7 million is allocated to the development programme.

In the field of basic education, resources will be targeted to developing learning methods and learning environments and to ensuring access to basic education.

Preparations are underway for a reform of upper secondary education financing and the network of education providers. The aim is to improve the impact, quality and effectiveness of upper secondary education and to ensure the availability regionally of upper secondary education.

## **Vocational education and training**

Preparations are underway for a reform of the vocational education financing and governance system. The aim is to develop a unified and coherent vocational education and

training system by integrating the separate financing and governance systems of vocational upper secondary and vocational further training and apprenticeship training. The restructuring and process reform of the provider network for vocational education and training will be launched on a voluntary basis.

## **Higher education institutions**

Higher education institutions shall improve their division of labour and so strengthen their profiles, as well as increase collaboration with one another and with research institutes. Functional and structural development within and between different sectors will be continued in order to pool skills and knowledge and to eliminate duplication and overlap. New efficiencies and the rationalisation of the higher education network mean that central government funding to higher education institutions will be reduced by EUR 75 million. In addition, index-linked increases to university and polytechnic funding will be discontinued in 2016–2019.

## **Financial aid for students**

Financial aid for students will longer be index-linked. Parental income limits determining the eligibility of independently living secondary-level students aged 18–19 will be raised by 13 % as of 1 January 2016. The changes to the student financial aid system will enter into force in autumn 2016.

## **Youth and sport policy**

Every effort will be made to ensure continued delivery of youth workshop and outreach youth work services and at the same time

to develop these services so that they better meet the needs of young people. These efforts are aimed at improving young people's life management skills and at reducing youth unemployment.

A further aim is to encourage a physically active way of life in the whole population and in this way to increase people's participation and to promote the population's health and well-being. In addition, every possible support is given to the ethically sound practice of sport at the highest international level.

## Arts and culture

Revenue from betting and lottery accounts for 51% or EUR 233 million of total budget allocations to arts and culture. The Helsinki Central Library, one of the projects selected to commemorate the centenary of Finnish independence, will be supported with the sum of EUR 8 million. An appropriation of EUR 6 million is allocated to the renovation of the Suomenlinna service tunnel, EUR 4 million of which will be made available in 2016.

## Agriculture and forestry

The Government is committed to strengthen the vitality of rural areas and to create the conditions for diverse and competitive entrepreneurship and business growth. A further aim is to promote the structural development of agriculture and so to improve its productivity. A key instrument to this end is the rural development programme for mainland Finland 2014–2020 and the funding made available through this programme.

Conditions for primary food production and processing will be improved and steps will be taken to protect the health of people, ani-

mals and plants, to promote animal welfare and to create a more responsible food supply chain.

## Transport



EUR 505 million is earmarked for transport infrastructure investments. A total of EUR 1.1 billion is set aside for daily transport infrastructure maintenance. Out of this sum EUR 100 million is part of the Government's investment in key projects and in reducing the transport infrastructure repair debt. The Helsinki railway yard development project will be launched in 2016 to minimise disruptions to commuter and long-distance rail services in the Helsinki region and elsewhere in Finland, and to increase the capacity of the railway yard.

Public transport subsidies will be reduced by EUR 15 million. EUR 10 million of this will be reallocated to purchases of long-distance rail services.

## Employment policy



The budget proposes an appropriation of EUR 2.85 billion for unemployment security, an increase of around EUR 100 million to the ordinary budget for 2015, which is mainly attributable to the growth of unemployment.

The proposed appropriation for public employment and business services is EUR 557 million, down by EUR 6 million from the 2015 ordinary budget. This is due among other things to the adjustment measures announced by the current and previous governments and to the weaker employment situation.

The Government will draft a proposal for a comprehensive reform of public employment and business services by the end of 2015. Resources will be focused on activating job seekers. The role of employment and economic development offices will be to provide a business and employer-driven employment service.

The criteria for eligibility to job alternation leave will be tightened to create annual savings of around EUR 50 million in general government expenditure. Central government savings will come to around EUR 10 million.

## Energy policy

The budget proposes an appropriation of EUR 248 million for subsidies to renewable energy production, an increase of EUR 34 million from 2015. The growing need for funding is due to the increased wind power capacity and the reduced tax on fuel peat.

## Social benefits and health insurance reimbursements

Child allowances will no longer be index-linked.

Savings on health insurance reimbursements will be achieved by reducing reimbursements for travel expenses as well as reimbursements for medical and dental care. Expenditure on discretionary rehabilitation services will be reduced by cancelling the planned AURA rehabilitation programme.

Savings on pharmaceutical expenses will be delivered by introducing an annual initial amount of medical expenses that the individual will be required to pay in full: eligibility for health insurance reimbursements will start beyond that level of prescription drug purchases. In addition a range of other measures will be introduced to curb the growth of pharmaceutical expenses.

The diet allowance will be discontinued from the beginning of 2016. This will deliver savings of EUR 10 million.

Income limits and reimbursement rates for the determination of sickness and parenthood allowances will be revised. The earned income limit for eligibility to a 70% sickness allowance will be lowered, and the increased component of parenthood allowance for the first 30 days of parental leave will be re-



duced. Furthermore, holiday entitlements accrued during periods of parental leave will be limited.

## **Pensions paid by central government**



EUR 4.7 billion is earmarked for the payment of pensions and compensations by central government under the Ministry of Finance main title of expenditure. EUR 4.3 billion is allocated to pensions under the Ministry of Social Affairs and Health main title of expenditure. National pensions totalling EUR 2.3 billion and guarantee pensions of EUR 192 million will be financed by the state. In addition, EUR 645 million will be spent on farmers' pensions, EUR 123 million on self-employed persons' pensions, EUR 59 million on seamen's pensions and EUR 15 million on farmers' occupational accident pensions.

The amount of the guarantee pension will be increased by EUR 23 a month. Taking into account the reduced housing allowance expenditure, the net cost effect in 2016 is EUR 26 million.

The pension recipient's housing allowance will be discontinued as of 1 January 2016. Pension recipients will be eligible to receive the general housing allowance instead. The

effects of this change on payments received by benefit recipients will be eased by EUR 30 million on an annual basis. In the future asset criteria will also be taken into account in determining general housing allowance eligibility. This will result in annual savings of EUR 7.5 million, which will also be used to counter the effects of pensioners' reduced level of housing allowance.

## **Veterans**

The budget foresees spending EUR 232 million on supporting war veterans. This appropriation takes into account the changes in disabled veterans' incapacity criteria for eligibility to municipal outpatient services: the threshold degree of incapacity is lowered from 20 % to 15 %. The cost effect amounts to EUR 5 million in 2016. The war veterans' rehabilitation appropriation will be increased by around EUR 50 per veteran compared with 2015.

## **Nature and the environment**

The Forest Biodiversity Programme for Southern Finland (METSO), the Natura 2000 network and other nature conservation programmes agreed upon earlier will be continued within the constraints of resources available. Appropriations for the acquisition of nature conservation areas and for compensation paid to landowners will be reduced by EUR 20 million in line with the Government Programme. The budget proposes an appropriation of EUR 38 million for the public administrative duties associated with Metsähalitus' nature services. This includes the sum of EUR 8 million allocated to the completion of the conservation measures in areas already designated as nature conservation sites.

## Housing

Municipalities in the Helsinki metropolitan area can be granted temporary start-up assistance of up to EUR 10 million with a view to increasing state-subsidised rental housing production. The authorisation for interest subsidies to state-subsidised social housing production is EUR 1,170 million, for loan guarantees EUR 285 million, and state

guarantees for housing companies' renovation loans EUR 100 million. The majority of state-subsidised housing production shall be concentrated in major growth centres, particularly the Helsinki region.

EUR 25 million is earmarked for renovation assistance. Most of this will go to financing repairs in the homes of old and disabled people and to the retrofitting of lifts.



# Inquiries

## **Budget Department**

Director General

Hannu Mäkinen,

tel. +358 2955 30330

Deputy Head of Budget Department

Juha Majanen,

tel. +358 2955 30247

## **Ministry of Finance<sup>2</sup>**

Snellmaninkatu 1 A

PO BOX 28, 00023 GOVERNMENT

Tel. +358 9 295 160 01

Fax +358 9 160 33123

## **Budget review 2016**

ISSN 1797-9714 (zine)

ISBN 978-952-251-749-4 (zine)

Ministry of Finance publications 2c/2016

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<sup>4</sup>[Julkaistuotanto@vnk.fi](mailto:Julkaistuotanto@vnk.fi)